

**Testimony by
The Honorable Curtis M. Loftis, Jr.
State Treasurer**

**House Committee on Small Business
Subcommittee on Contracting and Workforce
Defer No More: The Need to Repeal the 3% Withholding Provision
May 26, 2011, 10:00 A.M.
Room 2360, Rayburn House Office Building
Washington, DC**

Position:

Support full repeal of Section 511, 3% withholding on government contracts.

Comments:

Mr. Chairman and members of the Committee, I am honored to be here today. Thank you for the opportunity to testify on this very important matter.

I urge you to repeal the federal 3% withholding provision, Section 511, which imposes a burdensome and costly mandate that will affect contracts at all levels of government. Additionally, it will negatively affect businesses throughout the country. While the 3% withholding requirement was designed to increase tax compliance, it will unfairly penalize state and local governments and especially small businesses that run honest taxpaying companies.

The impact and unintended consequences of this withholding requirement on both governments and companies are detrimental. Excessive implementation costs come at a time when the public sector is trying to recover from economic havoc. Additionally, compliance with this requirement will prove financially oppressive to private industry and will cost jobs.

And, who will ultimately bear the cost of this new requirement? The taxpayer.

While I serve as the State Treasurer of South Carolina, I am also a small business owner. I would like to share with you how I see the impact of this law.

First, let's look at the negative effects on state and local governments.

The provision imposes administrative costs and information reporting requirements for implementation and maintenance of (1) the vendor tax withholding requirement, and (2) payment of the tax on behalf of the vendors to the Internal Revenue Service.

In addition to these costs, the requirement presents an administrative nightmare. Modifications to accounting systems and other administrative processes will have to be resolved. Add up the manpower and dollar costs of the withholding provision for all of the local and state governments across the county and you will find the amount is astronomical.

Coupled with administrative costs, many believe that vendors will increase their prices to governmental entities to compensate for this penalty tax in order to minimize their revenue losses. Some, if not all of the costs, may be passed on to governments through higher contractor bids. As a result, taxpayers will pay more.

The withholding law will negatively affect government budgets at a time when every dollar counts. Public budgets are already strained and budget woes continue to persist nationwide. Lower levels of government may not be able to sustain the burden of altering accounting systems and providing other services necessary to administer the program.

Federal tax compliance enforcement is the function of the IRS, not of state and local governments.

The withholding requirement is equally harmful to our businesses...especially its small businesses.

The 3% withholding requirement penalizes all tax compliant businesses. It forces them to provide the federal government with an interest-free loan by requiring advance payment of taxes that may not be due at the end of the year.

The provision will seriously affect businesses' cash flow, which has already been impacted by the economic downturn. The withholding is based on gross revenues from contract payments and has no relationship to businesses' taxable income. Businesses with tight profit margins will lose vital funds necessary for operations, and as a result, will be forced to pass the added costs on to their government customers. Cash flow may be damaged to the point that some businesses withdraw from doing business with government altogether. Business expansion could be halted or deferred. Additional cash flow constraints could push some companies out of business completely.

Of course I am particularly concerned about what Section 511 will do to small businesses in my home state. Small business is essential to the financial well-being of South Carolina. In 2008, there were nearly 364,000 small businesses and they account for nearly 50% of private-sector jobs. Small firms made up 97 percent of South Carolina's employers.

Small business is the engine that drives South Carolina's economy. The success of the small business sector is critical to my state's economic recovery. The withholding requirement will reduce the amount of capital available for payroll, new business investment, and daily expenses.

The continued success of existing small business, along with new business enterprise, is key to South Carolina's ability to increase its gross state product, state personal income, and total employment. I am confident that the same is true for all of the other states. So, why tamper with economic performance by imposing this expensive and unwieldy withholding requirement?

South Carolina's unemployment rate in April was 9.8%, the ninth highest in the country. Marion County continued to have the highest jobless rate at 18.7%. It should be noted that these rates do not include those individuals who have stopped looking for jobs or those who have collected maximum benefits. Nor does it reflect those who are underemployed.

There's a saying "an error we refuse to correct has many lives." I believe the negative consequences of this mandate will snowball. You are privileged to have the opportunity to make it right by repealing it.

I strongly urge the members of this Committee and the House to take action as quickly as possible to repeal Section 511.

In closing, I would like to commend Representative Herger for his work on H.R.674 which will repeal this onerous requirement, and Chairman Mulvaney for holding today's hearing on this issue.

Again, I appreciate the opportunity to testify before you today. I will be happy to answer any questions.